ST 00-0001-PLR 02/22/2000 SALE OF SERVICE

This letter discusses the application of the Service Occupation Tax Act to repairs made under four programs of an automobile manufacturer's warranty program. (This is a PLR.)

February 22, 2000

Re: (a manufacturer's) Warranty Program

Dear Mr. Xxxxx

This private letter ruling will acknowledge receipt of your letter dated January 10, 2000. We have reviewed your letter and the documents appended thereto. We have also reviewed the supplemental materials you sent on February 16, 2000. In your letter, you have requested a ruling on the application of the Illinois occupation and use tax laws to automotive part replacement transactions (under manufacturer's) Warranty Program.

From the information you provided, we understand that (manufacturer's) Warranty Program consists of the following four components; (the written limited warranty), (safety related recalls), (non-safety related recalls) and (after-warranty repairs). All (four) are intended to correct defects in materials and workmanship at factory expense. (Manufacturer's) dealers make (the) repairs…and then (the manufacturer) pays those dealers for the repairs at rates governed by the terms of the Warranty Program.

The Written Limited Warranty

As you indicate in your letter, there is no controversy surrounding repairs made under the (written limited warranty). The (written limited warranty) is the basic factory new vehicle warranty, which covers the entire vehicle for X years or XXXX miles, whichever comes first. The (written limited warranty) may cover certain components for longer periods (e.g., rust---X years or XXXX miles, emission system---X years or XXX miles). The (written limited warranty) is something that the customer has paid for as part of the purchase price of the vehicle and which (the manufacturer) is obligated to honor if a problem arises as the result of a defect in materials or workmanship during the warranty period. Since the sale of the vehicle was subject to ROT/UT when the vehicle was purchased, including that portion of the selling/purchase price attributable to the (written limited warranty), repairs made under the (written limited warranty) are not subject to SOT/SUT.

However, questions related to the taxability of repairs made under the remaining 3 components of (the manufacturer's) Warranty Program have arisen. Your descriptions of those remaining 3 components and our conclusions concerning taxability are as follows:

(Safety Related Recalls) are intended to address defects in materials or workmanship identified with respect to a segment of vehicles produced that bear on safety. Notice of such defects is made by mailings to customers and

to dealers, advising customers to bring their vehicles in for repair free of charge. The time for such repairs to be made on such terms is open ended.

Repairs made by dealers under a (safety recall) are not subject to Illinois sales tax liability. Our reasoning for this conclusion is essentially the same as the reasoning for the no tax conclusion for repairs that are made under the (written limited warranty). Customers purchasing vehicles pay for vehicles that are free from defects in materials and workmanship. In turn, (manufacturer) is obligated to provide those customers with vehicles that are free from defects in materials and workmanship. In other words, as you indicate in your letter, the sale of (one of manufacturer's vehicles) results in an enforceable agreement between (manufacturer) and the customer that the vehicle being purchased is free from manufacturing defects. This agreement can extend to repairs necessary to correct defects in material and workmanship even after the (written limited warranty) has expired. We agree that a repair (manufacturer) is obligated to make as a result of this agreement is something that the customer has paid for as part of the purchase price of the vehicle. When such a repair is made under a (safety recall), the customer is receiving something that he paid for and which was taxed when the vehicle was purchased. For that reason, repairs made under a (safety recall) are not subject to tax.

(Non-safety Related Recalls) are intended to address defects in materials or workmanship with respect to a segment of vehicles produced that do not raise safety concerns but bear on the customer s satisfaction with a vehicle. (D)ealers are notified of a given (non-safety recall) by (manufacturer) through bulletins that they are to maintain and make available to customers... Moreover, owners of vehicles covered by a (non-safety related recall) are notified by mail. Unlike (safety recall) repairs, (non-safety related recall) repairs must be made within a time period specified by (manufacturer) if they are to be make free of charge.

We think that repairs made under a (non-safety recall) are not taxable for the same reasons that repairs made under a (safety recall) are not taxable. The fact that repairs made under a (non-safety recall) are not safety related does not change that analysis. The fact that these repairs must be made within a reasonable time frame does not change that analysis either. In fact, we understand that the time limit for repairs made under a (non-safety recall) is an attempt at distinguishing problems attributable to a manufacturing defect from problems attributable to normal wear and tear or some other cause… For example, as we understand it, if a part in a class of vehicles is suspected as being defective, the thought is that it will fail within a given time period. If the part fails and the vehicle in which it is installed is brought to a dealer for repair within that time period, the presumption is that the failure was due to the part being defective. On the other hand, if the part fails after the time limitation, the presumption is that the failure was due to wear and tear.

As with the (safety recalls), we think that the keys here are the facts that:

these (recalls) consist of repairs (manufacturer) is obligated to make under an enforceable agreement between (manufacturer) and the customer that the vehicle purchased is free from defects in materials or workmanship; and

the agreement was paid for by the customer and was taxed as part of the purchase price of the vehicle.

(After-warranty repairs are) intended to address defects in materials or workmanship identified by a customer and confirmed by a dealer to not be the result of aging, owner abuse or physical damage, or lack of proper maintenance. Dealers are authorized to independently make such determinations within X years or XXXX miles after the (written limited warranty) expires on a given vehicle, although (manufacturer s) oversight is available to resolve any disagreement about the appropriateness of a repair sought to be covered by an (after-warranty repair).

We think that (after-warranty repairs) result in service occupation tax/service use tax liability. We acknowledge that (after-warranty repairs) are repairs necessary to correct defects in materials or workmanship. However, we can not conclude that (after-warranty repairs) are made under the enforceable agreement between (manufacturer) and the customer that was purchased when the customer paid for the vehicle. (Manufacturer) takes the position that it is not obligated to make (after-warranty repairs). For example, (manufacturer's literature) which describes (after-warranty repairs) provides that:

"(After-warranty repairs are) outside the parameters of the written warranty (and) may exist where special consideration is in order to enhance customer satisfaction and loyalty.

* * *

"Case-by-case individual (after-warranty repairs) are not legal obligations like the terms of (manufacturer's) warranties."

Similarly, (another piece of manufacturer's literature) states, at page XXX, that:

"Remember, (after-warranty repairs) are not Legal obligations like the terms of (manufacturer's) Warranties. (After-warranty repairs) are intended to recognize that circumstances, outside the parameters of the written warranty, may exist where special consideration is in order to enhance customer satisfaction and loyalty."

As we read these materials, we can not conclude that (after-warranty repairs) are the result of an enforceable agreement between (manufacturer) and the customer that was taxed as part of the purchase price of the customer's vehicle. (Manufacturer) disclaims any obligation to make (goodwill repairs). If the customer had pre-paid for the (after-warranty repairs) at the time the vehicle was purchased, (manufacturer) would be obligated to make them and (manufacturer) could not disclaim that obligation. We think (after-warranty repairs) are made apart from any obligation that (manufacturer) incurred when the vehicle was purchased. Consequently, we think that (after-warranty repairs) subject dealers furnishing those repairs to liability under the Service Occupation Tax Act.

IN THE (AFTER-WARRANTY REPAIR) SITUATION, THE DEALER MAKING THE REPAIRS INCURS A SERVICE OCCUPATION TAX LIABILITY AND (MANUFACTURER) INCURS A SERVICE USE TAX LIABILITY.

When (after-warranty repairs) are made, we think that under the terms of the Warranty Program agreement between (manufacturer) and its dealers, the dealer making the repairs functions as a serviceman and (manufacturer) functions as the service customer. We do not have a copy of that agreement but we understand that it authorizes dealers to make (after-warranty repairs) and requires (manufacturer) to pay for those repairs at previously agreed rates. We think that establishes the serviceman/service user relationship.

As we see it, by way of the Warranty Program agreement, (manufacturer) instructs the dealer to make authorized (after-warranty repairs) and deliver the repair parts to the vehicle owner. That instruction constitutes the exercise of an incident of ownership over the parts and that makes (manufacturer) a service user. The fact that the dealer has received the instruction in the form of the Warranty Program agreement, before the repairs are actually made, does not change the analysis. (Manufacturer's) instruction to the dealer to make authorized (after-warranty repairs) and deliver to the customer is on going and continues for as long as the Warranty Program agreement is in effect. Under this arrangement, we think (manufacturer) does take title to the repair parts and then title passes to the vehicle owner. If your assertion that (manufacturer) does not take title to the repair parts and, for that reason, can not be a service user is correct, then no transaction in which repair parts (or any other item of tangible personal property) is paid for by someone other than the person to whom the item is delivered could be taxable under the Illinois sales tax laws.

Very truly yours,

George Sorensen
Deputy General Counsel
Sales and Excise Taxes